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The Director of Central Intelligence
Washington, D.C. 20505

NIC #03608-84
21 June 1984

National Intelligence Council

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

VIA: Chairman, National Intelligence Council

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: European Gas Security

I prepared this memorandum in response to your request of 18 June. The key points are that the West European governments, whose projections had overstated the likely future growth of gas demand during the negotiations over the Siberian pipeline, appear now to be underestimating future demand. This underestimate is removing much of the urgency from efforts to develop alternative gas sources, especially for Norway. In addition, there is a specific political problem in the UK which may slow development of Norwegian gas. The Soviets are in a good position to take advantage of any lag in Norwegian gas development and by the time the Europeans see the need more clearly, it may be too late to develop alternative solutions.

Maurice C. Ernst

Attachment:
As stated

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European Gas Security

The US effort to head off a likely increase in West European dependence on Soviet gas in the 1990s by encouraging development of alternative sources, particularly from Norway, may be encountering some new difficulties. Official West European forecasts of gas demand have shifted from over-optimism to what will probably be over-pessimism, as a result of which the development of new secure gas sources will be delayed. In addition, internal British politics may block early development of the large Norwegian Sleipner field, which in turn would probably further delay development of the even larger Troll field--the principal alternative to additional Soviet gas in the 1990s. If European gas demand increases more rapidly than governments and utilities now expect, as seems likely, construction of a large new pipeline from the USSR, which would take only about two years, may be the only way to cover West European gas needs in the mid-to-late 1990s, since the lead times on Norwegian gas development of sufficient scale are much greater. Moscow could offer not only prompt delivery of gas, but also lower prices and additional contracts for large diameter pipe and other gas line equipment.

European projections of gas demand through the remainder of the 1980s and through the 1990s have gone through a cycle of optimism and pessimism. In the early 1980s, official gas demand forecasts projected fairly rapid increases, reflecting the trend of the 1970s, when gas had been priced below alternative fuels and consequently was being substituted for them in a number of uses. These high demand projections were a major reason for the sense of urgency in West European governments during negotiations with the USSR for construction of the Siberia to Western Europe pipeline. In 1981, it was widely believed in Western Europe that there would be sufficient demand fo fill the pipeline to capacity before 1990. In the course of the pipeline negotiations, however, European gas demand began to fall not only as a result of the economic recession, but also because the price of gas had reached near parity with oil products, and substitution of gas for these fuels stopped. It took some time, almost two years, for official forecasts to catch up with reality. Private forecasts by oil companies and gas utilities were revised downward first; government forecasts were lowered later. As gas demand continued to decline, successive forecasts were lowered further, and the latest ones show little increase in gas demand over the next decade, in spite of nearly a 6 percent growth rate in 1983.

The trouble is that gas demand has begun to turn upward and will probably continue to increase faster than current official forecasts. These forecasts are strongly influenced by the recent downward trend in demand and also reflect a pessimistic view of the prospects for economic

growth in Western Europe. In addition, these forecasts apparently do not consider the flexibility some suppliers have recently begun to show over gas prices and probably reflect an unrealistically high price for future gas deliveries. The chances are that it will take two years or so of fairly strong demand growth to force the beginning of a process of upward revisions of official demand forecasts. This perception lag combined with the current gas glut could cause substantial delays in the development of new non-Soviet gas sources. Although the desirability of developing such sources, especially Norwegian gas from the Sleipner and Troll fields, has been generally agreed upon in the IEA, the low gas demand forecasts make it extremely difficult to imbue Western gas purchasers or their governments with any sense of urgency, particularly in view of the availability of additional Dutch gas. Absent a sense of urgency, all kinds of problems are likely to arise that can delay development of these gas sources.

An important problem of this sort is the political debate within the British government over whether or not to go ahead with a tentative understanding to purchase large amounts of gas from Norway's Sleipner field beginning in the early 1990s. This understanding, which took 18 months to negotiate, is strongly supported by Dennis Rooke, Chairman of the British Gas Corporation, but is opposed by Nigel Lawson, Chancellor of the Exchequer and former Energy Secretary. One alternative being considered is to purchase smaller amounts of natural gas from Dutch offshore fields, and to accelerate development of some British fields. A compromise solution, under which the British would import smaller amounts of Norwegian gas, also is being considered. The issue involves [redacted] 25X1
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perceptions of UK national interests.

British purchase of Dutch gas has a desirable feature--it would entail construction of a trans-channel gas pipeline, which would connect the UK and continental gas networks for the first time and consequently enhance the overall flexibility of the system. But both this option and the option to purchase smaller amounts of Norwegian gas than originally envisaged have the major disadvantage of almost certainly delaying development of the Sleipner field for some time. Since the Norwegians do not want to begin negotiating the sale of the larger Troll field until Sleipner's development is certain, Troll development also would be delayed. Furthermore, the volume of Dutch gas available to the Continent would be substantially reduced if the UK were to import from the Netherlands.

If European gas demand should rise fairly rapidly in the next few years and if the development of the Sleipner and Troll fields is delayed, by the time West European governments have revised their gas demand forecasts upward, it may then be too late to bring Troll on line soon

enough to meet this new demand. Industry sources indicate that the first phase development of Troll will take 8 years, on top of a probable 2 years of contract negotiations. This analysis suggests that by 1987-88, additional large-scale purchases of Soviet gas may once again seem an attractive proposition to the West Europeans. The Soviets are extremely well positioned to supply this gas. Their reserves are ample. They have completed four long-distance pipelines in 1981-83; are well along on the fifth, and apparently plan to build three more in the next five year period. The laying of pipe takes only about one year and no more than a second year is needed to get a pipeline to a large fraction of its ultimate capacity. Moscow can price its gas below any large alternative source and still make a substantial profit. The Soviets can also offer massive contracts for large diameter pipe and pipeline equipment to West European firms that have become highly dependent on the Soviet market. Taken together, these inducements would be hard to resist.

Should Moscow be able to substantially increase its gas exports to Western Europe in the 1990s, it would obtain large additional hard currency earnings with which to buy Western equipment and technology, could reduce the strain on its oil supply at a time when oil production will almost certainly be declining, and will have further tightened its economic linkages with West European countries, which in turn would tend to strengthen West European interests in stable or improved relations with Moscow.

WESTERN EUROPE: Changing projections of Gas Demand in 1990

Billion Cubic Meters

	1978	1980	1982	1983	1984
IEA[a]	325	310	295	270	237
Firm A	310	270	255	240	NA
Firm B	330	360	270	265	NA

[a] Country submissions to the IEA plus France and Finland